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■ THE GREAT CIGARETTE SCAM • PRODUCTS OF THE YEAR • HOW TO HELP AMERICA'S SCHOOLS ■

DECEMBER 4, 1989

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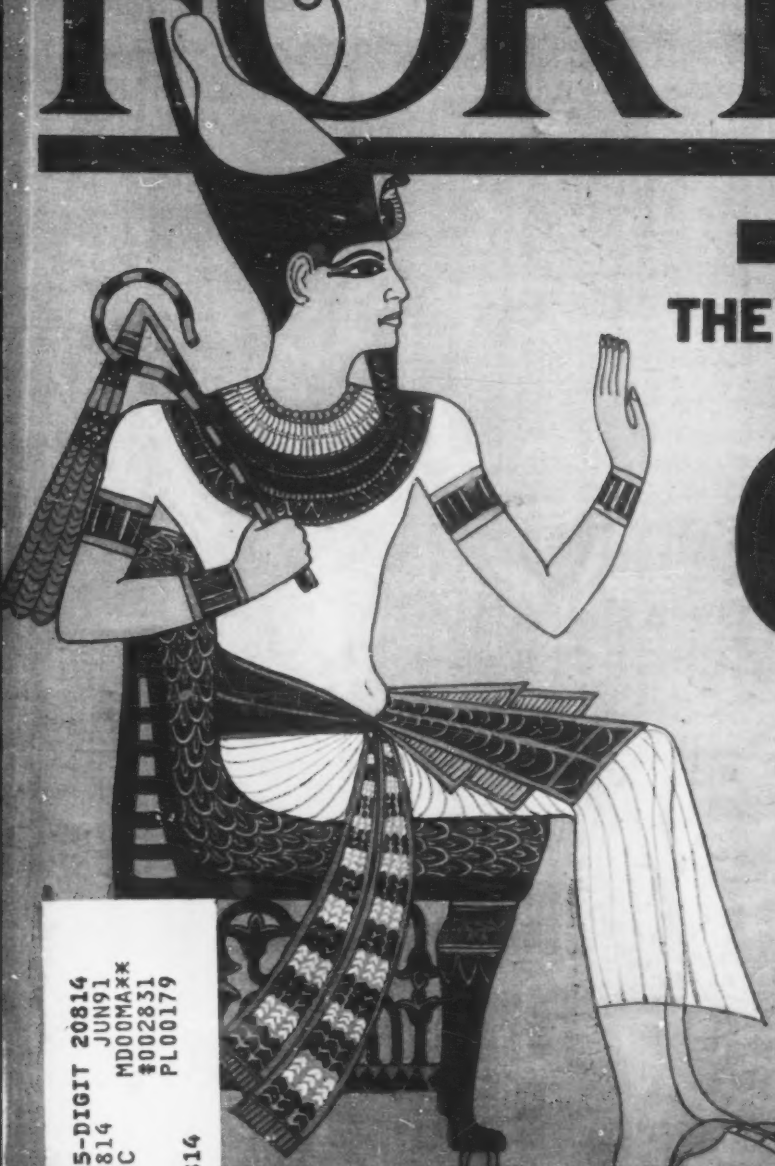

THE TRUST GAP

Pharaoh in all his glory would have envied today's CEOs their perquisites and ever-sweetening pay. Too busy living the cosseted life, America's managerial elite have lost touch with the humble employee. Workers' faith in top management is collapsing. CEOs who don't come down from the heights are in for trouble.

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ABOVE: Bosses, Teamsters, and longshoremen at Preston Trucking in Harrison, New Jersey, photographed by Andy Freeberg.

COVER: Painting by Kinuko Y. Craft.

At Preston Trucking, workers give their all primarily because they believe management gives them full attention and respect. PAGE 56

MANAGING/Cover Story

THE TRUST GAP 56

Corporate America is split by a widening gulf between top management and everybody else—in pay, in perks, in self-importance. People below the acme of the pyramid trust those on top just about as far as they can throw a Gulfstream IV, with shower. The attitudes of middle managers are becoming more like those of disaffected hourly workers. Here's how to regain employees' confidence. *by Alan Farnham*

AUTOS

JAPAN'S NEW CARS 82

They're large, powerful, more rounded and stylish, and packed with electronic goodies. For big spenders, Nissan has a sedan that can cost $45,000 with options. *by Sally Solo*

TROUBLE

THE $600 MILLION CIGARETTE SCAM 89

By stocking up wholesalers with more smokes than they could promptly resell, RJR Nabisco created a ton of bogus profits. Its competitors were in this game too. *by Carol J. Loomis*

MONEY & MARKETS/CEO POLL

WHO BUSINESS BOSSES HATE MOST 107

Ask leading U.S. corporate chiefs which professions help society—and stand back, especially if you work in Wall Street. *by Terence P. Paré*

CORPORATE PERFORMANCE

HOW DISNEY KEEPS THE MAGIC GOING 111

Want to turn your company into an idea factory without losing financial control? Try CEO Michael Eisner's elixir. *by Christopher Knowlton*

IMAGINEER EISNER ON CREATIVE LEADERSHIP 116

EVERY STORE IS A STAGE 132

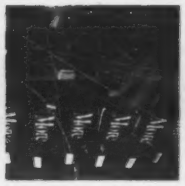
COMPANIES TO WATCH 136

Stokely USA makes it big in veggies for the microwave; also, Watsco, Network Computing, and BHA Group. *by Sandra L. Kirsch*

VOL. 120, NO. 14

"You can immerse a mouse in water that's been treated with perfluorocarbons, and he'll be able to breathe."

PAGE 31



"It's like getting in with a loan shark."

PAGE 89

"The pursuit of ideas is the only thing that matters. You can find people to do almost everything else."

PAGE 116

"Education is not a priority to compete with defense, deficits, drugs, or AIDS. It is the solution to those problems."

PAGE 137

"Japan's educational system, far from deserving emulation, stands in need of the most drastic reform."

PAGE 155

"It's hard to use any term other than friendly when the offer is all cash at a 50% premium over market."

PAGE 173

SPECIAL REPORT

HOW TO HELP AMERICA'S SCHOOLS 137

In the global marketplace, mental might increasingly separates winners from losers. A FORTUNE conference of corporate leaders, educators, and politicians suggests a wealth of ways to keep U.S. education reform rolling. Above all, they say, raise expectations. *by Nancy J. Perry*

GIVING PARENTS A CHOICE 147

What's good for business—namely competition—can be good for public education. Done right, plans that let families and teachers pick their schools get high marks. Public school choice is simply the hottest item on the education reform agenda today *by Jaclyn Fierman*

A LOOK INSIDE A JAPANESE SCHOOL 155

You won't find closed-circuit TV or the kind of flashy media centers so popular in affluent schools in the U.S. What you do see is surprising dedication. But many Japanese are becoming dissatisfied with the system. They argue that the country needs fewer worker bees skilled at memorizing and more creative thinkers who can question established ideas. *by Carla Rapoport*

INNOVATION

PRODUCTS OF THE YEAR 162

FORTUNE's ninth annual collection of what's trendiest, hottest selling, and most inventive ranges from Gillette's $3.75 Sensor razor, which has twin chromium blades individually mounted on tiny springs, to Mazda's $13,800 (if you're lucky) Miata MX-5, a sexy four-cylinder roadster inspired by the popular English two-seaters of the 1950s and 1960s. *by Edward C. Baig*

DEPARTMENTS

EDITOR'S DESK 4

INDEX 8

NEWS/TRENDS 10

The new era of possibilities, a bum rap for program trading, who owns America's landmarks, computer wars (cont'd), and more.

FORTUNE FORECAST 25

The upbeat mood of CFOs and other executives will see the economy through its slow spell. GNP growth will rise again in 1990. *by Todd May Jr.*

PERSONAL INVESTING 31

How to buy safe food stocks without paying gourmet prices. *by Patricia Sellers*

Also: Big-time managers for the little guy, investment programs for your PC, and Portfolio Talk with Ken Oberman of Oppenheimer Global.

LETTERS TO FORTUNE 51

FORTUNE PEOPLE 173

Georgia-Pacific's Marshall Hahn on his takeover bid, *USA Today*'s Cathleen Black on whether Al Neuharth is sexist, Polly Peck's Asil Nadir on biting off Sansui, and more. *by Alan Deutschman*

ON THE RISE 176

BOOKS & IDEAS 179

Author Michael Lewis (*Liar's Poker*) has doubts about Bill Emmott's doubts that Japan will become a dominant economic power.

KEEPING UP 185

Seeking fame in Congress, why liberals are richer, and other matters. *by Daniel Seligman*

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EDITOR'S DESK

WHAT can private business—and specifically you and I—do to help alleviate the crisis in America's public schools? Searching for direct, workable answers and practical solutions, FORTUNE gathered together more than 200 leaders of business, government, labor, and academe in Washington, D.C., for our second annual Education Summit. In the year since our precedent-setting 1988 conference and the provocative cover story that followed it, education has risen to the top of the national agenda.

At this year's two-day session, which was organized with the help of consultant Rhea Stein and sales promotion manager Carol Ahlers, Apple Computer Chairman John Sculley made the point that education is key to the survival of the nation's economy, while New Jersey Governor Thomas Kean said that it is essential to the survival of America's democracy. Chairmen and presidents from Merrill Lynch, the New England insurance company, U.S. West, and Eastman Kodak explained what their companies are doing to help schools and students in their own communities.

Our special report on education, beginning on page 137, elaborates on ways that companies and individuals can combat the crisis. The project was supervised by assistant managing editor Ann Morrison and senior editor Richard I. Kirkland. The lead story in the package examines the need to lengthen the school day and expand the school year, raise the status (and sometimes the pay) of teachers, and make preschool programs available to many more youngsters. The article was written by Nancy Perry, our education specialist, who will continue to cover the beat in her new assignment as FORTUNE's Los Angeles bureau chief.

HOWARD E. SIMMONS
Nancy Perry

JOE BURN
Alan Farnham

ANDY FREEBERG
Carol Loomis

The second piece, "Giving Parents a Choice of Schools" by Jaclyn Fierman, herself a new parent, analyzes the hottest trend in public school reform. From Tokyo, Carla Rapoport reports in "A Look Inside a Japanese School" the surprising fact that the Japanese are trying to reform their schools too—to promote more creativity among their highly motivated, highly disciplined students.

Meanwhile, our cover story beginning on page 56 addresses another kind of problem: "The Trust Gap." Writer Alan Farnham, working with reporter Andrew Erdman, explains why corporate America is split by a growing gulf between top management and everybody else—and how companies can regain employees' confidence. Assistant managing editor Walter Kiechel, who oversaw the story, says, "Alan is the first to fully explore the dramatic escalation in CEOs' pay with the steady decline in the worker morale. And he has done it with wit and an ear for the English language."

In another remarkable story in this issue, writer Carol Loomis draws on her considerable knowledge of accounting to expose "The $600 Million Cigarette Scam." Assisted by reporter Mark Colodny, she documents precisely how RJR Nabisco, indeed the entire tobacco industry, misled shareholders by artificially pumping up sales, profits, and market share. Julie Connelly, who edited the story, says, "This is the parable of a company that perverted its business to maintain market share."

Marshall Loeb
MANAGING EDITOR

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WHO BUSINESS BOSSES HATE MOST

Ask America's leading corporate chief executives which professions help society—and then stand back, especially if you work anywhere near Wall Street. ■ *by Terence P. Paré*

DO AMERICA'S TOP CEOs like investment bankers? Yes, the way W. C. Fields liked children—parboiled. As takeovers and leveraged buyouts continue to proliferate while some from the past come to grief, U.S. business leaders conclude overwhelmingly that investment bankers are overpaid and more interested in thickening their wallets with fees than in advancing clients' interests. No, the vast majority of CEOs do not want government meddling with Wall Street pay. But while a sizable proportion dissent, most feel that the dealmaking engineered by financial types is hobbling America's ability to compete globally. The true contributors to the commonweal? Executives—and the clergy.

Q A **Which of these professionals make a major contribution to the well-being of society and the economy?***

Manufacturing executives	47%
Clergy	44%
Commercial bankers	32%
Executives of service corporations	30%
Accountants	18%
Journalists	7%
Investment bankers	6%
Management consultants	6%
Executives of search firms	4%
Stock analysts	4%
Investment consultants	2%

*Rated eight or higher on a ten-point scale of how much each contributes to the well-being of society and the economy.

These are among the most notable findings in the latest FORTUNE 500 CEO Poll. Clark Martire & Bartolomeo, an independent opinion research firm, conducted the survey of 206 chief executive officers of FORTUNE 500 and FORTUNE Service 500 companies between October 25 and November 3.

REPORTER ASSOCIATE *Reed Abelson*

Given a list of professionals, CEOs chose executives like themselves as major contributors to society far more often than they named anybody connected with Wall Street. Manufacturing executives were singled out most often, beating all comers including the clergy. Sacrilege? No, partly a public relations problem. Many executives note that with Jim Bakker in the slammer and other evangelists touched by scandal, the man of the cloth's image is a bit stained. N. Berne Hart, chief of United Banks of Colorado, explains the relative rankings as a problem of accounting: "With manufacturing executives it's so many tons of this or so many thousands of that. I don't know how a priest or a clergyman adds up what he does."

Other workers whose output is hard to evaluate ranked low in the eyes of the CEOs. Only 7% of them said that journalists made major contributions to society. Management consultants were no more esteemed than investment bankers, with 6%. Even less well thought of were stock analysts and headhunters. A mere 2% of the chiefs felt that investment consultants made large contributions to society. Explains Raymond C. Burton Jr., boss of Trailer Train, a railcar cooperative: "I don't think any of us really knows what is going to be the right thing to invest in. But investment consultants parade themselves as knowing."

The CEOs reserve their most bitter bile for investment bankers. Fully 95% believe investment bankers emphasize fees rather than the long-term interests of clients. Loyalty is dead. Says Charles F. Casey of plastic-container maker Constar International: "The switch over the years from a relationship-oriented industry to a transaction orientation has really put a credibility gap between the investment banker and his client." The investment banker who helps you with an initial public offering today could come knocking with a hostile tender offer tomorrow. Says Ryal R. Poppa of computer equipment manufacturer Storage Technology: "You just can't trust them as you could in the past."

"Employees are not getting anywhere near the returns investment bankers are."

RICHARD F. TEERLINK
Harley-Davidson

JAMES SCHNEPF

Edmund M. Carpenter of electronics outfit General Signal sees another kind of change: "In some cases investment bankers are making the market rather than responding to the needs of the market." The equity stakes investment bankers commonly take these days trouble Richard F. Teerlink of Harley-Davidson, the motorcycle maker. How can investment bankers give an objec-

"What's going to happen to the manufacturing base of our country?"

ALEXANDER F. GIACCO
Himont

JIM LUKOSKI—B. PICTURES

tive opinion of a deal if they will be affected by their decision? Says Teerlink: "There's a potential for a conflict of interest."

The lightning rod for much of this excoriation is salary. Most executives would kick Wall Streeters right in the pocketbook. Teerlink is burned not by how much the investment bankers earn but by how little others are paid: "The real people who are investing in companies are the employees who are putting in sweat equity, and they're not getting anywhere near the returns investment bankers are."

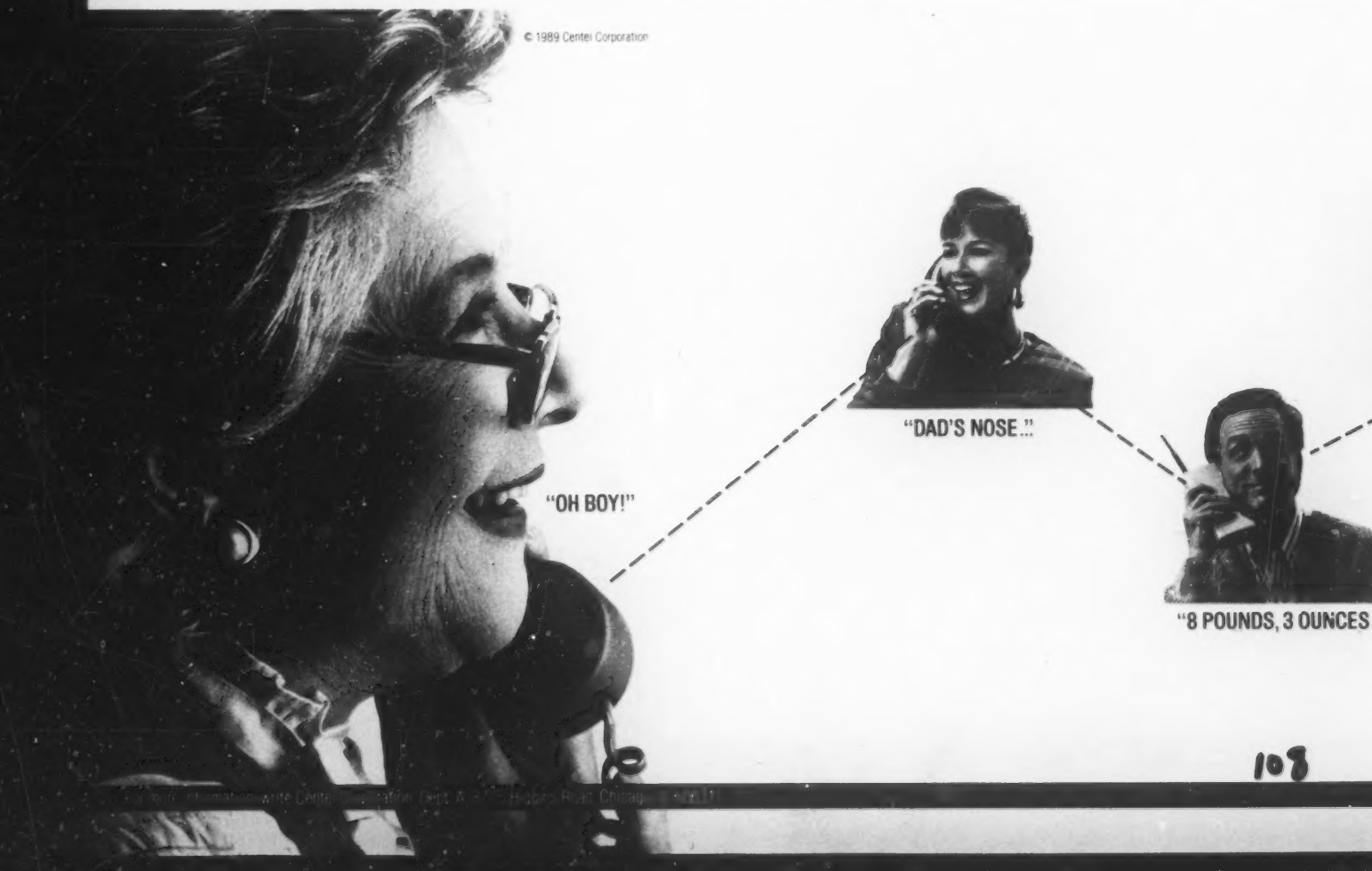
SOCIETY, OF COURSE, does not necessarily suffer because a small number of its members are paid more than they are worth. But 68% of CEOs feel that the deals driven by investment bankers hurt America's ability to compete in the global market. "Instead of building industries, investment bankers are making money by tearing them down," says James C. Cotting, boss of truckmaker Navistar International. The chiefs particularly decry the emphasis that frenetic mergers and acquisitions place on the short term—called the Maypo syndrome, playing off U.S. Budget Director Richard Darman's references to old TV commercials for the breakfast cereal in which a misbegotten little monster demands that his mother serve his Maypo *now*. CEOs feel that unless they deliver attractive returns immediately, an investment banker could come calling with a takeover bid in a briefcase thinner than the smile on his face.

Result, they say: The best-laid long-term plans, vital in a world increasingly dominated by the far-sighted Japanese, will inevitably go awry. W. R. Wilson, chief executive of steelmaker Lukens, says, "It's hard to keep your eye on the ball long-term if you have to keep looking quarter to quarter." Bausch & Lomb chief Daniel E. Gill concurs: "Any CEO knows that for a year or two, maybe even three or four years, you can show tremendous profitability quarter after quarter. All you do is curtail maintenance, curtail advertising of new products, and cut out technology investments."

Like many CEOs, Tom E. Smith of Food Lion, North Carolina's supersuccessful grocery chain, worries about the wider economic impact of nonstop dealmaking: "So much emphasis has been placed on Wall Street and leveraged buyouts that it has detracted from good, sound investments. That hurts the economy." Alexander F. Giacco of chemical maker Himont thinks some U.S. industry could end up out of business. He says, "You push too many of these deals and you have to ask, 'What's going to happen to the manufacturing base of our country?' " Paul R. Roedel, head of specialty-metals maker Carpenter Technology, warns, "We will not feel the

Q **Do you feel investment bankers are overpaid?**
A
Yes **95%**
No **5%**

Q **If so, would you recommend government regulation of these fees?**
A
Yes **7%**
No **87%**
Not sure **6%**



full impact of this phenomenon for many years, and then I am afraid it will be too late."

Not that these corporate bosses oppose all mergers and acquisitions. They despise deals created for the deals' sake when investment bankers whip rival suitors into an acquisitive fury. But Giacco says, "Each of us can think of an acquisition we've made or an acquisition we'd like to make." For that, investment bankers are necessary, like it or not. Capping the fees investment bankers earn could slow down the M&A action, yet 87% of CEOs oppose any kind of government interference in the market. Previous polls show that these chiefs reject most government intervention in business. John B. McCoy of Banc One offers a more specific reason for leaving dealmaking alone: "If we curtail mergers and acquisitions, I don't think our companies will be as strong," he says, on the theory that the Darwinian struggle between predators and potential prey keeps companies fit. The price of that benefit is putting up with the fee-crazed hotshots of investment banking.

A minority of the surveyed CEOs, 22%, follow a different line of reasoning, contending that the takeover wave is fundamentally good for the U.S. because it forces companies to cut fat, restructure, and become more efficient. Many economists endorse this view—but then they don't have jobs at stake when the raider comes knocking.

In the movie *Wall Street*, financier Gordon Gekko tells how greed is good. The CEOs do not agree, as their comments and their rankings demonstrate. Pointing to the second-most-esteemed profession on the list, Trailer Train's Burton says, "The clergy can tell you all about greed." F

Q **Do you believe investment bankers are putting more emphasis on deals and fees than on the long-term interests of their corporate clients?**

A

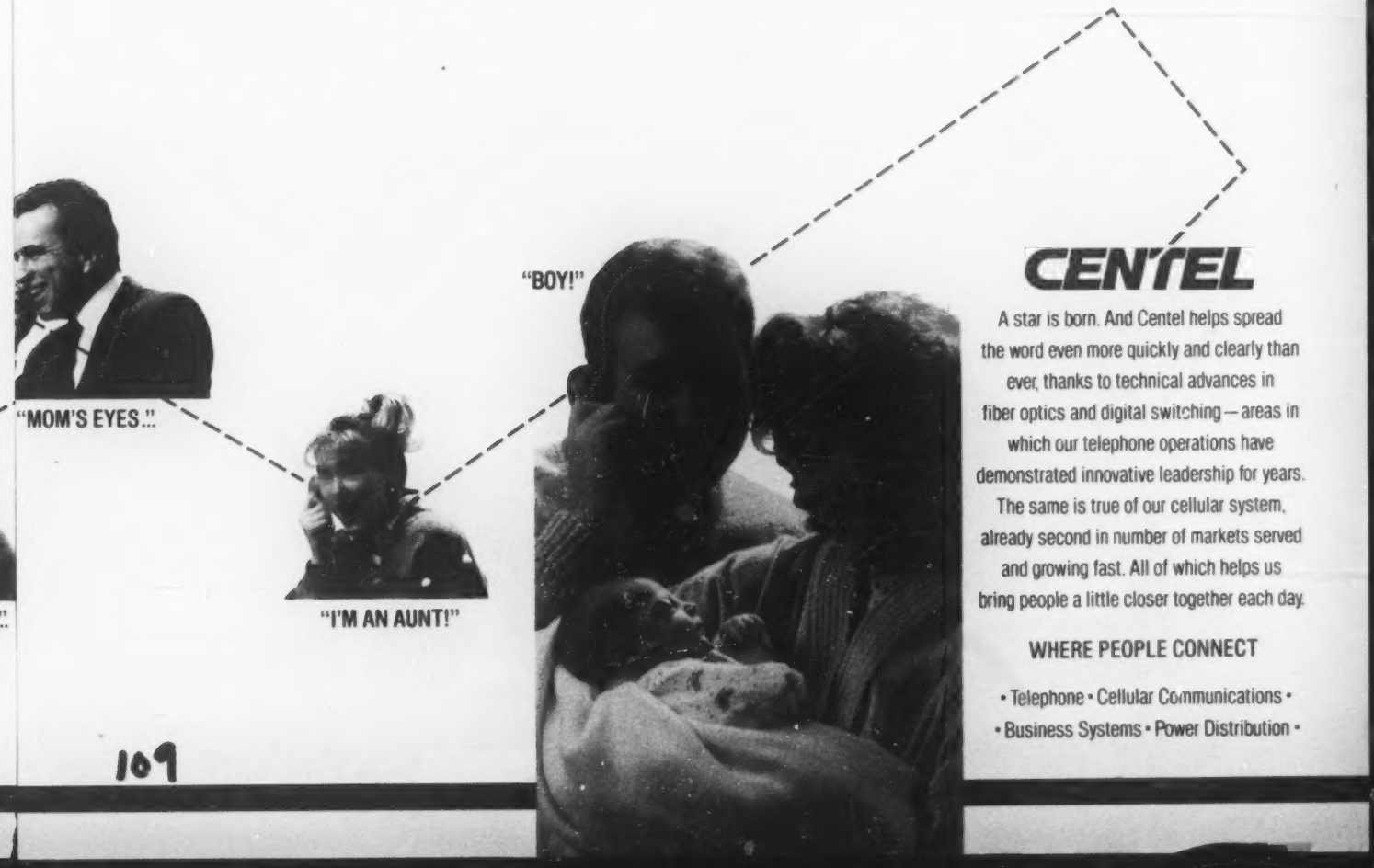
Yes	95%
No	5%

Q **Do you think that Wall Street's merger and acquisition activity helps or hurts America's ability to compete in the global market? Why?***

A

It has hurt	68%
Too much emphasis on short term	36%
Too much debt	16%
Too much emphasis on finance rather than production	14%
Less attention given to managing the company	9%
Less money for R&D	9%
Other	10%
It has helped	22%
Improved efficiency	11%
Forced global competitiveness	11%
Restructured assets more effectively	3%
Restructured positions within companies	2%
Other	2%

*Percentages total more than 100% because of multiple responses.



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A LOOK INSIDE A JAPANESE SCHOOL

Don't expect fancy fixtures or lots of expensive electronic gadgets. But you will find plenty of discipline and determination—it's back to basics. ■ *by Carla Rapoport*

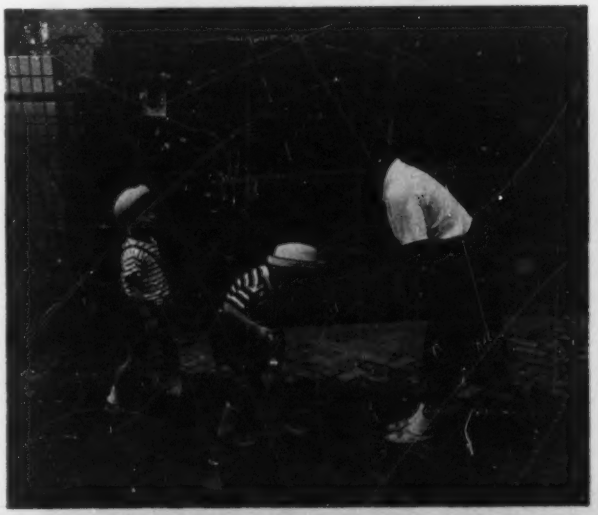
JAPAN'S STUDENTS score so high against other youngsters in standardized international tests, and its schools turn out such able workers and managers, that the country's educational system has become the envy of the world. But what really happens inside a Japanese elementary school? On these pages you can get a glimpse at classes for youngsters age 6 to 12 at the Azabu public school in central Tokyo.

There isn't much glitz. Despite Japan's newfound wealth, the government has not lavished more money on education. Japanese schools, like Japanese factories, are unadorned, functional places. You won't find closed-circuit TV or the kind of flashy media centers so popular in affluent suburban schools in the U.S.

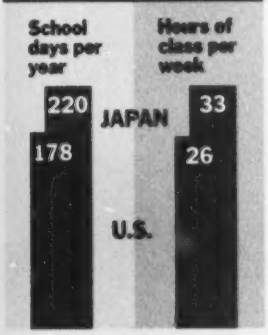
What you do see is surprising dedication. There are rows of neatly dressed youngsters (elementary schools don't require uniforms) in large classrooms paying close attention to their teachers. If a slogan could be written over any Japanese school, it would be *gambatte*—try your best. Japanese children may be no smarter than those elsewhere, but they undoubtedly work harder. They spend more time in school than do Americans—an average of 220 days a year, vs. 178—and they have more homework. They memorize more too.

Partly they have to. Mastering the Japanese writing system, which is based on more than 2,000 Chinese characters, requires a great deal of memorization. The third-graders on this page were able to write their names only this year. Learning enough characters to read most newspapers and books takes until the end of ninth grade. But they *will* manage it; literacy in Japan is virtually universal. And in math and science these children, along with others across Japan, will streak

REPORTER ASSOCIATE *Cindy Mikami*



How they compare



Lessons in manners begin in kindergarten, with a bow to the teacher each day.

Science projects are a big hit with third-graders in Azabu school. That's a helmet beetle.

PHOTOGRAPHS BY JOE MCNALLY—SYGMA

This opinion board, where kids post their views on school programs, is a recent innovation.

Classes in Japan are large—and orderly. But no student gets much individual attention.

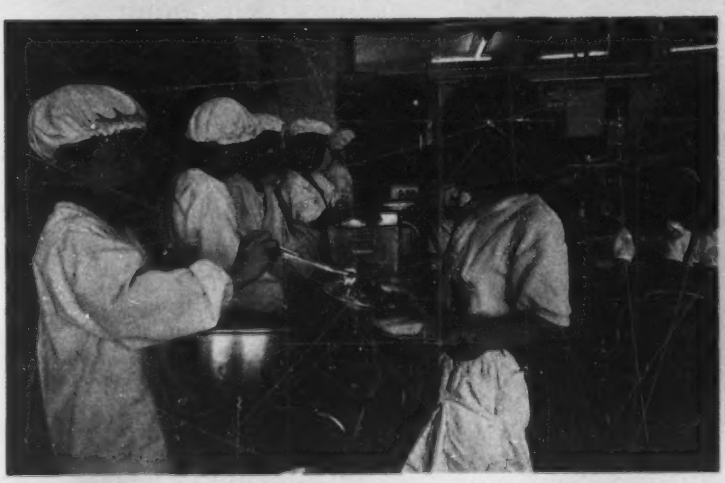
ahead of their American counterparts.

Despite these successes, many Japanese are becoming dissatisfied with the system. They note that Japan is changing and no longer needs legions of worker bees. Rather, they argue, the country now requires more thinkers, creative people, and students who can question established ideas, not merely memorize them. Says professor Teruhisa Horio, dean of education at Tokyo University: "Our educational system, far from deserving emulation, stands in need of the most drastic reform."

One problem is that a person's place in Japanese society is still largely determined by educational achievements. Children know that their chances of entering a major university and getting a good job depend almost entirely on the results of their high school exams. The pressure is so intense that by the fourth or fifth grade most children start attending after-school cram classes. This kind of one-track goal inhibits independent thought, say the critics.

In typical Japanese fashion, blue-ribbon committees have been formed and government studies launched on how schools can become less rigid. Says Shigenori Yano, chief of textbook planning for the Ministry of Education: "Up until recent times conformity was necessary to get as many people as possible through the educational system. Now that job is complete, so we have to go a step further. Our purpose will be to stimulate creativity."

By 1992, he explains, Japanese children will get something that Americans have long been familiar with: choice. Starting in junior high, brighter children will be allowed to take special advanced courses in science, foreign languages, and math. In



Without a cafeteria, students eat in the classroom, served by classmates.

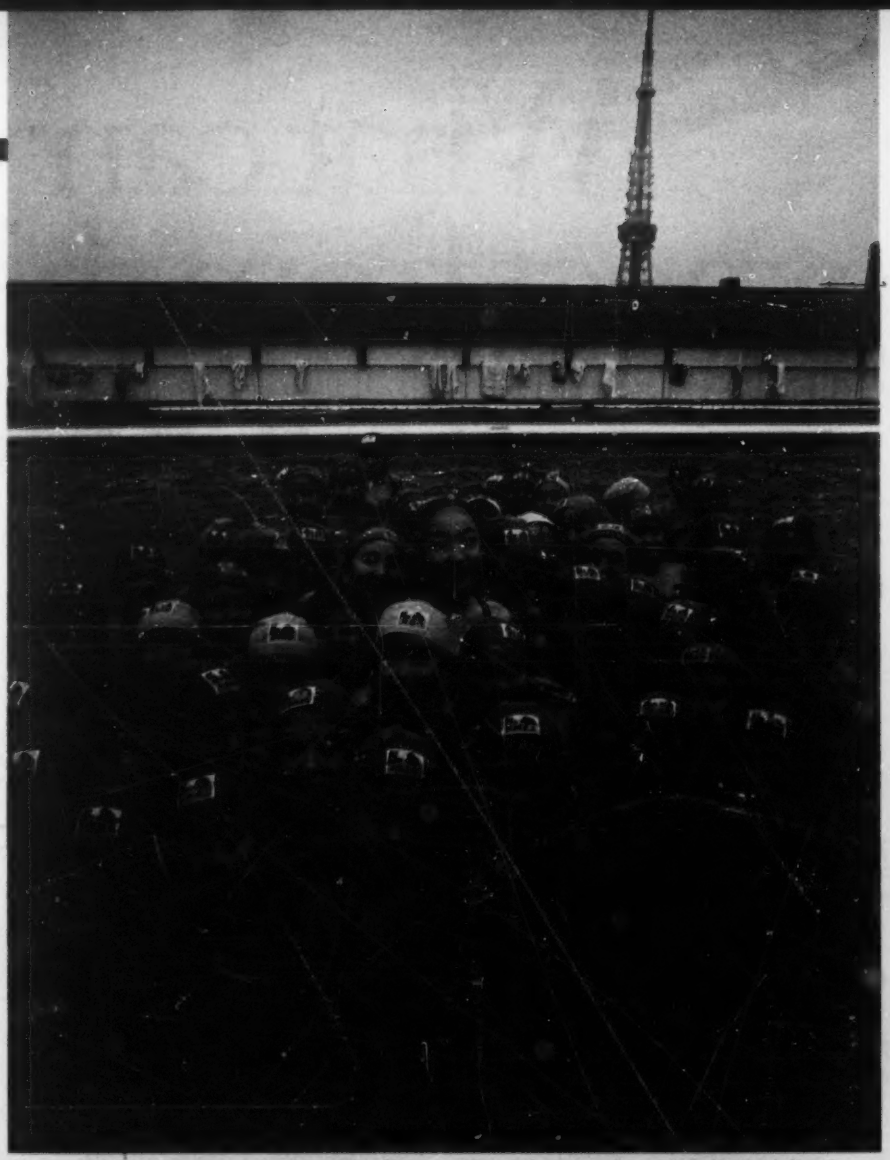
By first grade, kids have learned to listen to the teacher.

senior high, students studying English will be able break out of the grammar/memorization loop and choose from a range of courses including essay writing and conversation.

Some test programs have already begun in elementary schools. A few years ago the government designated Azabu as an experimental school. Azabu chooses themes each year and gears its curriculum and special events accordingly. Two recent themes: learning to live in an international society and learning to communicate more openly with others.

While these may sound rather tame to Americans, educators in Japan have long emphasized the opposite. They have encouraged children to believe that as Japanese they are unique in the world and that nonverbal communication is often more important in relationships than speaking. To help students communicate more easily, the school held a series of assemblies. After a brief lecture, students were told to discuss the topic. No one said anything at first; a lively exchange developed only after a few months.

Nobuyuki Terashi, principal of Azabu, says a switch to a system based on choices is long overdue. But the changeover won't be easy. Observes Masako Kubota, a fifth-grade teacher in the school: "I have 43 pupils in my class. That's too many. I can't try to encourage their individualism. Japanese teachers are taught how to control a group, and this is our advantage. But it's our dream to have smaller classes and work one-on-one with kids." ■



Class spirit is strong, even in the water. The pool is on the school's roof. Self-discipline is part of kendo (below), an ancient martial art, which is taught in after-school classes.